Affordability pressures could support renovations activity

Housing affordability across Australia has deteriorated significantly since the pandemic began.

The pandemic produced housing and renovations booms across the developed world. People wanted more space and amenity in their home environment, given how much extra time they were spending at home. This was aided by government stimulus and support, while rock bottom interest rates made it easier to borrow. Lockdowns and social distancing also diverted spending away from services like travel, entertainment and dining out, towards home improvement.

The subsequent scramble for home building materials around the world occurred at the same time that global supply chains were struggling to turn back on. This resulted in the price of those materials blowing out by a third compared to pre-pandemic levels. Half of this increase occurred in the 2021/22 financial year alone.

Even as materials shortages eased, the shortage of skilled tradespeople in Australia remained acute. So much so, that the price of these trades has increased by almost a quarter since the pandemic began.

The result has been that the cost of building new housing has soared. The most recent data shows that the average value of a new house being approved across Australia is almost $130,000 more than before the pandemic.

It is true that pressures on materials and labour have eased dramatically. Home building materials prices, after increasing by 17.3 per cent in the 2021/22 financial year, increased by just 7.4 per cent in 2022/23. Similarly, the price of skilled trades increased by just 3.4 per cent in 2022/23, compared to almost 10 per cent in 2021/22.

Notwithstanding these more moderate increases, these prices rarely go backwards.

Since the 1960s, home building materials prices only declined significantly on three occasions:

- In the wake of the 1987 Wall Street Crash and Australia’s “recession we had to have”;
- The Asian Financial Crisis and Australia’s housing downturn in the mid-90s; and
- Following the introduction of the GST in 2000 and the 2001 Tech Crash.

Even the Global Financial Crisis couldn’t produce significant declines.

Similarly, trades prices in Australia have only declined twice in the last 20 years: during the Global Financial Crisis and towards the end of the last apartment boom in 2017.

This suggests that it is unlikely that a ‘correction’ in materials and labour pressures will provide much relief.

Nor is land getting any cheaper.

Land prices have surged as people across the country sought more space and amenity in their living environment and demand shifted towards larger lot sizes. The median lot price nationally is up by more than $60,000 since the pandemic began.

This is to say nothing of the policy decisions that have been compounding these costs for years:

- Planning systems that inhibit higher density residential development in existing suburbs near jobs and transport.
- Long-winded greenfield land release processes and inadequate infrastructure provision.
- Punitive and inefficient taxes on both investors and owner occupiers.
- Financial regulations that make it harder for banks to lend and potential home buyers to borrow.

Combine these with the sharpest tightening of monetary policy settings in a generation from the Reserve Bank, and the cost of building and financing a new house has become prohibitively high.

These pressures are also flowing through to the price of existing housing.

Construction cost blowouts, together with record population growth, pre-existing acute shortages of rental accommodation and a well-employed labour force, mean existing home prices are on the way back up again after a year of respite. Strong fundamentals have overpowered the impact of rising interest rates, and at recent rates of growth, the price of existing homes could be back to all-time highs by the end of the year.

At the same time, the dearth of new home sales entering the pipeline over the last year is set to produce the weakest year of new house commencements in over a decade.

This does not bode well for housing affordability but is, ironically, probably supporting the renovations sector.

Renovations activity has been booming on the back of the same pandemic demands for home improvement that drove demands for new housing: policy stimulus and support, household savings, and the pandemic desire for space and amenity in our home environments.

The difference at present is that affordability constraints in the new and existing home market are becoming more binding. This makes more affordable renovations look like an increasingly appealing alternative to achieving such home improvement.

Extreme weather events have also created a need for home repairs. This will continue to support activity in the coming years.

There is also a wave of homes that were completed in the 1990s, now approaching the 30-35 year age bracket where significant renovations are often undertaken.

These factors are why we expect the low point of the cyclical to be still greater than anything seen before the pandemic.

There is a laundry list of policy changes that need to come from the Reserve Bank, the financial regulators, and all levels of government to improve housing affordability.

Until such time, the outlook for renovations will remain brighter than for new housing.

Renovations vs Housing Stock, Moving Annual Total, Australia

Source: ABS, HIA